STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Office of General Counsel

May 29, 1996

William F. Caton
Acting Secretary
Federal Communications Commission
Washington D.C. 20554

Re: In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996
CC. Docket No. 96-98

Dear Mr. Caton:

Enclosed pleased find for filing with the Commission an original and sixteen copies of the Reply Comments of the Illinois Commerce Commission. As indicated on the enclosed certificate of service, I have transmitted a copy of these comments on paper and diskette to Janice Myles and Gloria Shambley in the Commission's Common Carrier Bureau. I have also forwarded a copy of these comments to the Commission's copy contractor.

Please acknowledge receipt of this filing by date-stamping and returning the enclosed duplicate copy of this letter in the envelope provided.

Sincerely,

David W. McGann
Special Assistant Attorney General
Illinois Commerce Commission
160 North LaSalle Street
Suite C-800
Chicago, Illinois 60601
(312) 793-3305

Counsel for the Illinois
Commerce Commission

DWM/mtx
Encls.

CERTIFICATE OF SERVICE

I, David W. McGann, an attorney, hereby certify that copies of the Initial Comments of the Illinois Commerce Commission in Federal Communications Commission Docket Number 96-98, were served upon the persons on the attached Service List, by overnight mail, postage prepaid, on this 29th day of May, 1996. In addition, I served a computer diskette copy of the Reply Comments of the Illinois Commerce Commission in Federal Communications Commission docket Number 96-98 via overnight mail on Janice Myles and Gloria Shambley of the Commission's Common Carrier Bureau.

David W. Mc Gann

SERVICE LIST FEDERAL COMMUNICATION COMMISSION DOCKET NUMBER 96-98

William F. Caton
Acting Secretary
Federal Communications Commission
Washington D.C. 20554

Janice Myles
Common Carrier Bureau
1919 M Street, N.W.
Room 544
Washington D.C. 20554

International Transcription Services, Inc.
2100 M Street, N.W.
Suite 140
Washington, D.C. 20554

Gloria Shambley
Network Services Division
Common Carrier Bureau
Federal Communications Division
2000 M Street, N.W.
Suite 210
Washington D.C. 20554

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	))))	CC Docket No. 96-98

REPLY COMMENTS OF THE ILLINOIS COMMERCE COMMISSION

May 30, 1996

Table of Contents

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	))))	CC Docket No. 96-98

REPLY COMMENTS OF THE ILLINOIS COMMERCE COMMISSION

I. Introduction

The Illinois Commerce Commission ("ICC") respectfully submits its reply comments to the Federal Communications Commission ("FCC") in the above-captioned proceeding, as allowed by the Notice of Proposed Rulemaking ("NPRM").

The ICC has focused its reply comments to respond to certain positions taken by the United States Department of Justice ("DOJ"). Many of the issues raised in other parties' comments have been adequately addressed in the ICC's initial comments. Further, as the FCC undoubtedly realizes, the sheer volume of comments prohibits comprehensive responses within the deadline established by the NPRM.

The ICC appreciates the willingness the FCC has shown thus far in working with the States, and hopes to continue this dialogue during the remainder of the rulemaking process and

beyond. The ICC further commends the FCC for its efforts to make the comments available electronically, thus significantly facilitating the parties' ability to review the comments in preparation of reply comments.

The DOJ will play a central role during the review of Bell operating company ("BOC") requests for in-region interLATA authority under section 271.[1] Because of this, the ICC anticipates that the FCC will give significant weight to the DOJ Comments in this docket. While the ICC agrees with significant portions of the DOJ Comments, the ICC believes that certain aspects of the DOJ Comments demand response.

The DOJ, understandably, sets forth what it believes is sound public policy that would allow it and the FCC to alleviate antitrust concerns surrounding BOC interLATA entry. However, the DOJ does not recognize adequately the statutory limitations regarding the FCC role versus the State role in implementing the 1996 Act. Further, certain aspects of the economic theory it espouses do not bear up to scrutiny.

---

[1]Unless noted otherwise, cites are to sections of the Communications Act of 1934, as added or amended by the Telecommunications Act of 1996 ("the 1996 Act").

II. What the DOJ Views as "Sound Policy" is Not Necessarily Authorized by the 1996 Act

The DOJ Comments center around its view that "sound policy" requires the adoption of broad national standards. For example, the DOJ states that:

> (T)he adoption of national standards...would constitute a sound policy choice by the [FCC]. To be sure,...we believe the FCC should...avoid unnecessary and unwise intrusions into the prerogatives of the states. DOJ Comments at 12.

"Sound policy" arguments aside, the FCC does not have the statutory authority to make some of the "intrusions" espoused by the DOJ. A threshold issue is whether the FCC has the needed legal authority to act, before one reaches the question of whether a particular national policy would be an "unnecessary and unwise" intrusion. Reasonable people may differ in their opinions regarding "sound policy," and the DOJ apparently disagrees with Congress in certain respects regarding the respective roles of the States and the FCC in implementing the 1996 Act. Regardless of views regarding "sound policy," the FCC must operate within the scope of its statutory authority.[2]

A particular example where the DOJ Comments recommend that the FCC go beyond the scope of its authority is its recommendation that the FCC not allow reciprocal interconnection or unbundled access obligations to be imposed on non-incumbent

---

[2] See ICC Comments at 5-8 for a full explication of the ICC's arguments regarding the limits on the FCC's statutory authority.

local exchange carriers. DOJ Comments at 22-23. The ICC agrees insofar as the DOJ argues against the imposition on non-incumbent LECs by the FCC of obligations reciprocal to those imposed on incumbent LECs by section 251(c). If Congress had intended to impose any section 251(c) obligations on all LECs on a national basis, it could have included such obligations in section 251(b). The imposition of reciprocal obligations on new LECs on a rigid, nationwide basis would not necessarily further the Congressional goal of opening each of the local exchange monopolies to competition.

The ICC strongly disagrees, however, with any inference that FCC rules should not allow States the discretion to impose specific duties on new LECs if policy goals consistent with the 1996 Act are furthered by the imposition of such obligations within a particular State.[3] Section 251(d)(3) prohibits the FCC, in prescribing and enforcing its section 251 rules, from precluding the enforcement of any regulation, order, or policy of a State commission that:

> (A) establishes access and interconnection obligations of local exchange carriers;
> (B) is consistent with the requirements of [section 251]; and
> (C) does not substantially prevent implementation of the requirements of [section 251] and [new Part II of Title II of the Telecommunications Act of 1934]. (emphasis supplied.)

---

[3] See ICC Comments at 18-20.

If a State determines, on the basis of an assessment of local market conditions, that it is appropriate to impose one or more obligations on a new LEC, it should be allowed to do so, irrespective of whether the obligation is enumerated in section 251(c). The fact that Congress did not apply the requirements in section 251(c) on a reciprocal basis nationwide should not be seen as rendering such a State determination inconsistent with the requirements of section 251. There is no requirement of section 251 with which such a determination would be inconsistent.

Another area in which the DOJ would have the FCC inappropriately intrude upon the State jurisdiction is in the establishment of pricing principles. DOJ Comments at 24-26. Responding to paragraphs 117 and 118 of the FCC NPRM, the DOJ comments that the FCC has the authority to specify principles governing the prices that incumbent LECs may charge for facilities and services provided to their competitors. DOJ Comments at 24. The ICC strongly disagrees.

The DOJ points out that there is nothing in the language of sections 251 and 252 which "expressly precludes the Commission from establishing pricing principles or parameters for utilization by the states in individual proceedings," and goes on to assert that "we [are not] aware of anything in the legislative history that precludes the Commission from promulgating pricing

principles or parameters..." This is not the correct standard to apply in determining whether a federal agency is authorized to promulgate rules by a statute that (1) expressly confers rulemaking authority on some subjects, (2) expressly creates case-by-case authority on other subjects, and (3) recognizes the need for a federal-state partnership to implement the Congressional goals. The United States Court of Appeals for the District of Columbia Circuit considered another such statute in Amalgamated Transit Union v. Skinner,[4] and held that under such circumstances, rulemaking authority does not exist unless explicitly granted.

III. Cost-based Pricing Involves Considerable Judgment, Not Just Theory

The DOJ recommends that unbundled network elements and transport and termination be priced based on long-run, forward-looking economic costs, which the DOJ calls Total Service Long Run Incremental Costs ("TSLRIC"),[5] with possible inclusion of joint and common costs.[6] DOJ Comments at 27 and 31-32. While

---

[4]894 F.2d 1362.

[5]In Illinois, these costs are called Long Run Service Incremental Costs ("LRSIC").

[6]It appears that the DOJ also supports TSLRIC-based pricing for interconnection provided pursuant to section 251(c)(2) (see DOJ Comments at 42).

the ICC agrees that forward-looking costs are the appropriate basis for prices, caution must be taken in asserting that prices equal to the TSLRIC of a service are most efficient. See DOJ Comments at 28. This textbook theory must be tempered with recognition of real-world conditions. As described in the ICC's initial comments and reiterated above, pricing decisions are properly left to the States, which are better able to take into account local conditions and apply the judgment needed to reach sound conclusions on a case-by-case basis.

The DOJ's position that TSLRIC prices are the most efficient prices seems to hinge on its stated assumption "given the efficient provision of all other network components" by the incumbent carrier (DOJ Comments at 27) and, further, on an unstated assumption that all other prices faced by new entrants are also set at TSLRIC. However, existing markets are replete with examples of price differentiation and above-cost pricing. Pricing of an incumbent local exchange carrier's network at TSLRIC may result in efficient "make or buy" decisions by new entrants only if all other options are also available at TSLRIC. Contrary to the DOJ's assertions at page 29, TSLRIC pricing of an incumbent LEC's network may actually distort an entrant's decision toward over-buying use of the incumbent's network, instead of building its own facilities or using the facilities of

another provider, even if these other alternatives are more efficient.

The DOJ's view that "TSLRIC pricing for network elements will likely lead to lower prices to consumers" (DOJ Comments at 30) may not be accurate in some instances, as well. The DOJ expects that TSLRIC pricing for network elements would generate competitive pressures for incumbents to lower prices to consumers. The ICC shares this expectation, to the extent and in the areas where new entrants operate. However, the reality is that the incumbent may remain the sole provider of local service in significant portions of its territory, at least for a period of time. Care must be taken to ensure that customers without competitive alternatives are protected from inordinate rate increases on the path to competition. While it is true that significant local rate increases could make competitive entry more attractive, the resulting harm to customers while they are waiting for competition could make this avenue unacceptable.[7]

The 1996 Act does not relieve the FCC or the States of many aspects of their existing rate-setting responsibilities. The FCC has not addressed how TSLRIC pricing of section 251 services would fit within existing rate-making regimes. Would TSLRIC

---

[7]Increasing end user prices significantly above economic costs could also decrease efficiency, thus offsetting some of the efficiency gains that may occur due to cost-based pricing of incumbents' network elements.

pricing for interconnection flow through price cap mechanisms such as those adopted by the FCC and the ICC as an exogenous factor, thus raising the price caps and, potentially, prices for other services? The FCC did not address the interaction between the 1996 Act and its own price cap mechanisms in the NPRM, much less the effect of national, preemptive pricing standards on State ratemaking procedures. States arguably could be required, under existing law, to allow rates for other incumbent LEC services to increase to offset revenue losses arising from mandatory TSLRIC pricing.

The DOJ expresses concern about cross subsidization that it fears could occur if prices are based on historical costs. DOJ Comments at 31. The ICC fully supports the policy that prices should not be below TSLRIC, absent specific policy determinations that a particular service should be subsidized, and has based its pricing decisions on such a policy for many years. However, since the DOJ's primary concern with use of historical costs appears to be recovery of residual costs, i.e., the difference between a company-wide assessment of revenue needs and forward-looking costs, it is not clear why the DOJ concludes that designing rates to recover historical costs would lead to cross-subsidization. As long as prices are above TSLRIC, cross-subsidization does not occur. The ICC has generally used LRSIC as a floor, with the recognition that rates may be set above the

floor, as appropriate, to balance the various rate design objectives.

The DOJ also is concerned that pricing above forward-looking costs could subject competitors to a "price squeeze." DOJ Comments at 30. This is another problem that can be addressed without pricing network elements at TSLRIC, through the use of imputation and other requirements, as appropriate. Illinois has statutory requirements that services classified as competitive pass an imputation test relative to noncompetitive inputs.[8] Further, the ICC has applied three criteria to prices of certain noncompetitive services, to ensure that economic price discrimination proposed by Ameritech Illinois is not unreasonable:

> (1) Prices are set no higher than the price index permits under the alternative regulation plan, i.e., a price cannot increase by more than the change in the Price Cap Index plus 2 percent each year;
>
> (2) Prices are set above the LRSIC, with imputation of noncompetitive tariffed inputs in each submarket; and
>
> (3) The prices are fair, based on a consideration of other relevant ICC policies and objectives. Order in Docket 95-0201 et al., Consol. at 14.

Such criteria can be used to assess any concerns about price squeezes, without requiring TSLRIC pricing.

---

[8] See Section 13-505.1 of the Illinois Public Utilities Act. 220 ILCS 13-505.1.

The DOJ believes that TSLRIC pricing for transport and termination is appropriate, but recommends that the FCC consider possible advantages of bill and keep arrangements as an interim, and perhaps permanent, standard for pricing transport and termination. DOJ Comments at 34. After describing various potential advantages of bill and keep pricing, the DOJ concludes that:

> The most significant unresolved issue concerning the appropriateness of a bill and keep standard is whether, as a long term standard, it would adequately compensate carriers for incremental costs incurred at peak traffic times. If so, such a standard in the long run could lead to underinvestment in telecommunications plant and overconsumption of the service. If, in the long run, the [incumbent local exchange carriers] can demonstrate that continuing use of bill and keep creates these problems then they should be permitted to propose rates that are consistent with total service long run increment cost. DOJ Comments at 35.

As stated at page 80 of the ICC's initial comments, section 252(d)(2)(B)(i) does not prohibit States from approving bill and keep arrangements. However, the 1996 Act does not grant the FCC authority to impose bill and keep arrangements on intrastate charges for transport and termination of traffic. The States should retain the ability to adopt bill and keep arrangements for transport and termination, if they find such arrangements appropriate.

The DOJ recognizes that there may be difficulties in implementing a TSLRIC pricing standard and that there are "practical administrative problems." DOJ Comments at 33. While

recognizing that "certain states have accumulated a substantial body of experience with economic cost concepts," the DOJ urges the FCC to adhere closely to TSLRIC for a national standard. The ICC cautions, if the FCC chooses to adopt national pricing standards, that care must be taken to ensure that the standards properly recognize the diversity among companies. The FCC should not burden smaller LECs with unreasonable requirements, for example, expensive cost studies out of proportion to revenues of the services involved. National standards that require each company to perform comprehensive, detailed forward-looking cost studies may prove unduly economically burdensome under section 251(f)(1)(A). While, conceptually, the costs of complying with national standards could be recovered through universal service funding, such an expansion of universal service funding may not be beneficial. Absent universal service funding, a State commission may find it necessary, under section 251(f), to exempt some of the smallest carriers from section 251(b) and (c) requirements, even though they may operate in areas in which competition would otherwise be viable.[9] The FCC should allow

[9]The potential that preemptive national policies could lead to exemptions for smaller carriers granted under section 251(f) is a concern for all national policies, not just pricing policies, that the FCC may adopt. The FCC should craft all its policies in a manner that reflects small company conditions, to the extent feasible, to reduce the need for exemptions.

States to use proxy cost models or other methods to price small carrier services if needed.

In Illinois, unbundling, interconnection, and pricing requirements for small companies vary. The Illinois Public Utilities Act exempts companies with no more than 35,000 subscriber access lines from its LRSIC, imputation, and unbundling requirements and from its cross-subsidy prohibitions.[10] The ICC has determined that all companies, including the small companies, should be required to offer intraLATA presubscription.[11] The ICC exempted non-Tier 1 LECs from switched and special access interconnection requirements, but required that all companies allow line-side interconnection and local loop unbundling, upon a bona fide request. (The ICC deferred applicability to the small companies of the line-side requirements until January 1, 1998.)[12] The FCC should allow the States continued latitude to address small company conditions as appropriate to enable competition to develop in smaller and more rural areas.

---

[10] See Section 13-504(b) of the Illinois Public Utilities Act. 220 ILCS 13-504(b).

[11] 83 Il. Adm. Code Part 773.

[12] 83 Il. Adm. Code Part 790.

IV. The 1996 Act Should Not Be Read to Address Pricing of All Services

The ICC wishes to comment on the DOJ's statement that "Congress has directed that traditional rate-of-return and rate-based regulation be eschewed in favor of cost-based pricing." DOJ Comments at 26. This view apparently is based on the FCC's tentative conclusion that section 252(d)(1) "precludes states from setting rates by use of traditional cost-of-service regulation, with its detailed examination of historical carrier costs and rate bases." NPRM at para. 123, referenced by DOJ Comments at 28. The ICC discussed this tentative conclusion in its initial comments.[13]

Section 252(d)(1) reads as follows:

> Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section--
>
> (A) shall be--
>
> (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
>
> (ii) nondiscriminatory, and
>
> (B) may include a reasonable profit.

A plain reading of this language reveals that the use of rate-of-return costing methodologies is "eschewed" only in the context of setting rates for the interconnection and unbundled

---

[13] See ICC Comments at 42-43.

network elements that incumbent LECs are obliged to provide under section 251(c)(2) and (3). With respect to other services provided by incumbent LECs, both to other telecommunications carriers and to end users, there is simply nothing to indicate that rate-of-return regulation is no longer available as a ratemaking tool.

In fact, an argument can be constructed that by virtue of the placement of the parenthetical "determined without reference to a rate-of-return or other rate-based proceeding" in subsection (d)(1)(A)(i), rate-of-return methodologies might even be available for the determination of "reasonable profit" under subsection (d)(1)(B).

Far from a Congressional direction that traditional rate-of-return regulation be eschewed, section 252(d)(1)(A)(i) stands as a narrow restriction on otherwise available methodologies for establishing the rates charged by telecommunications carriers. Ultimately, the ICC's view is that just and reasonable rates should be set, consistent with State and federal law, using those methodologies most likely to promote the goals of the 1996 Act and to serve the public interest.

V. Many of the DOJ's Policies Regarding Interconnection and Unbundling are Reasonable

While taking issue with some of the DOJ Comments, as discussed above, the ICC wishes to emphasize that it agrees with many of the DOJ positions regarding the physical provisioning of interconnection and unbundled network elements. The ICC agrees that any national interconnection and unbundling standards should be viewed as minimum standards, with States retaining the ability to determine that interconnection at additional points, or additional unbundling, should be allowed. DOJ Comments at 17-21; ICC Comments at, e.g., 10-13. Any minimum national rules should allow market-driven options to develop through the use of bona fide requests and, for incumbent LECs, the negotiation process in section 252. The ICC notes that a bona fide request approach is embodied in the Illinois Public Utilities Act,[14] and is the basis of the AT&T and LDDS requests for wholesale and network services pending in ICC Docket 95-0458 et al., Consol.

---

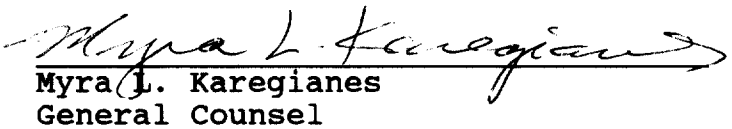
[14]Section 13-505.5 of the Illinois Public Utilities Act (220 ILCS 13-505.1) allows any party to petition the ICC to request the provision of a noncompetitive service not currently provided by a LEC. The ICC is required to grant the petition if it finds that the provisioning of the requested service is technically and economically practicable considering demand for the service, and absent a finding that provision of the service is otherwise contrary to the public interest. Section 13-505.6 (220 ILCS 13-505.6) allows the ICC to require unbundling of noncompetitive services, beyond that required by the FCC, if it finds that additional unbundling is in the public interest and consistent with the Illinois Public Utilities Act's policies and provisions.

The ICC also agrees with the DOJ's views that a party alleging network harm due to interconnection at specific points should have the burden of supporting its claim. DOJ Comments at 18; ICC Comments at 31. The ICC also supports the view that interexchange carriers should be allowed to obtain interconnection pursuant to section 251(c)(2) to provide exchange service and exchange access (DOJ Comments at 41-43; ICC Comments at 48-49) and that interexchange carriers should also be allowed to use unbundled network elements to originate and terminate interexchange traffic (DOJ Comments at 45-47; ICC Comments at 51-52).

VI. Conclusion

As these reply comments demonstrate, areas of disagreement remain, particularly regarding the federal and State roles in implementing the pricing standards in section 252(d). However, the ICC is hopeful that continued dialogue with the FCC and the DOJ will lead to the development of sound federal and State policies, within the statutory authority granted to each jurisdiction, that will allow effective competition to develop for telecommunications services.

Respectfully submitted,



Myra L. Karegianes
General Counsel
Special Assistant Attorney General
Illinois Commerce Commission
160 North LaSalle Street
Suite C-800
Chicago, Illinois 60601
(312) 793-2877